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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

May 14, 1986

LEGISLATIVE REFERRAL MEMORANDUM

TO: SEE ATTACHED DISTRIBUTION LIST

CONGRESSIONAL AFFAIRS
86 - 1583

SUBJECT: Department of Justice draft testimony concerning tort reform and the liability insurance crisis and related legislation.

The Office of Management and Budget requests the views of your agency on the above subject before advising on its relationship to the program of the President, in accordance with OMB Circular A-19.

Please provide us with your views no later than 10:00 a.m. -- 5/19/86.

(NOTE -- This is a firm deadline. If you do not respond by this time, we will assume you have no comment.)

Direct your questions to Branden Blum (395-3454), the legislative attorney in this office.

James C. Murr for
Assistant Director for
Legislative Reference

Enclosure

cc: Peter Wallison, Bill Coleman, Jeff Struthers, Boyden Gray, Bill Roper, Jack Carley, Tom Palmieri, Jeff Hill, Penny Jacobs, Tony Blankley, Alex Dimitrief

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STATEMENT

OF

RICHARD K. WILLARD
ASSISTANT ATTORNEY GENERAL
CIVIL DIVISION

U.S. DEPARTMENT OF JUSTICE

BEFORE

THE

HOUSE ENERGY AND COMMERCE SUBCOMMITTEE ON
COMMERCE, TRANSPORTATION AND TOURISM

CONCERNING

THE ROLE OF OUR CIVIL JUSTICE SYSTEM IN THE CURRENT LIABILITY INSURANCE CRISIS

ON

MAY 21, 1986

I appreciate the opportunity to appear before the Subcommittee to discuss the liability insurance crisis and the need for meaningful reform of our civil justice system.

As the Subcommittee is well aware, the liability crisis affects virtually every segment of American society -- manufacturers, professionals, small businesses, municipalities and nonprofit organizations. In some cases these groups have seen their liability insurance premium rates increase by up to 1,000 percent, if not more. Often, coverage is unavailable at any price, with devastating results. Many of these groups believe that tort reform and insurance availability are the most important issues they face today.

The Administration has been actively examining the sources of the insurance crisis, and has proposed sound and workable solutions to the problem. Last fall, the Attorney General, in his capacity as Chairman of the Domestic Policy Council, created the Tort Policy Working Group and appointed me as its chairman. The Working Group examined a number of aspects of the liability insurance crisis, and in February of this year issued a report with findings and recommendations for reform.

The Report of the Tort Policy Working Group on the Causes, Extent and Policy Implications of the Current Crisis in Insurance Availability and Affordability reviews the current financial condition of the insurance industry, and the economic factors leading to that condition. The property-casualty industry has suffered significant underwriting losses in the past two years ($21 billion in 1984; $25 billion in 1985) which have limited its

ability to offer as much insurance as its customers desire, and have made it reluctant to insure high risk activities which may expose it to further substantial underwriting losses.

Of course, the financial state of the insurance industry cannot be examined without considering the role of investment income. During the late 1970's and early 1980's, insurance companies engaged in a practice known as "cash flow underwriting". Commercial insurance premium rates were lowered as insurance companies vied for more dollars to invest at the high interest rates then in effect. Because there is a time lag of several years between the receipt of premium income and the payment of liability claims, the companies could subsidize lower premiums with income from investing the premiums in the meantime.

In recent years, declining interest rates have reduced insurance companies' investment income and contributed to increased premium rates. There is nothing we can or should do about this phenomenon. No one would suggest that we should return to high inflation and high interest rates in order to reduce liability insurance premiums.

Moreover, lower interest rates only partly explain the dramatic increases that have been experienced. The underlying cause is a substantial, long-term expansion of tort liability which has predictably contributed to the increased cost of liability insurance.

The fact that the insurance industry alone cannot be blamed for today's liability crisis was emphasized in a recent statement

by New York Mayor Edward Koch. He noted that the City of New York has had an "exponential growth" in its liability payments in personal injury cases -- from $24.2 million in 1977 to $114.2 million in 1985, a 375 percent increase. And, since New York City is totally self-insured, Mayor Koch observed that insurance industry practices have nothing to do with their increase in liability.

Notwithstanding this substantial evidence regarding the true causes of the liability insurance crisis, some persist in calling it a hoax or a conspiracy by insurance companies to raise prices. Recently both the Federal Trade Commission and the Antitrust Division concluded that there was no basis for further investigation of these implausible allegations. An advisory commission established by New York Governor Mario Cuomo recently reported a similar conclusion.

Let me emphasize that I believe the insurance industry is basically in good financial health and does not need to be "bailed out." The liability crisis primarily affects only a small segment of the property/casualty insurance business. Competitive forces should cause the price of such insurance to reflect the cost of liability imposed by the tort system.

The need for tort reform is thus not to protect insurance companies, but to protect large and small business and their employees, professionals, municipalities, non-profit organizations, and -- most of all -- consumers who ultimately bear the cost of liability.

The Working Group found that the explosion of tort litigation and expansion of liability in certain types of cases is directly correlated with the crisis in the availability and affordability of those types of liability insurance. Our civil justice system is no longer seeking to impose liability based upon traditional doctrines of fault. Rather, the system seeks to compensate plaintiffs at the expense of those who have the resources to absorb the costs.

Implicit in this legal trend has been the assumption that the insurance mechanism can handle an expanding liability system, at least within broad limits. Due to the escalating and unpredictable expansion of the liability system in recent years, this assumption is no longer automatically true. The Working Group concluded that the unpredictability and costliness of the liability system bear a direct relationship to the current problems with insurance availability and affordability.

In addressing these problems, the Working Group isolated four specific problem areas in tort law that particularly need to be addressed:

1. <u>The movement toward no-fault liability</u>

As I have indicated earlier in my testimony, <u>fault</u> has been the centerpiece of tort law since the days of the industrial revolution. Fault assigns liability based on the reasonableness of the actor's conduct or activity, distinguishing socially beneficial, from socially harmful, conduct. Stated differently,

without basing tort law on the concept of fault, we risk punishing those who do good -- whether by cleaning up asbestos or by manufacturing a childhood vaccine. In effect, without fault, tort liability becomes nothing more than a judicially imposed insurance scheme.

2. Undermining Causation

The gradual undermining of the requirement of causation through a variety of questionable doctrines and practices, has been used to shift liability to "deep pocket" defendants even though their actions did not contribute to the underlying injury or had only a limited or tangential affect.

While the attack on the requirement of causation cannot be attributed to any single innovation, one principal vehicle has been the expanded use of joint and several liability. The doctrine of joint and several liability allows the plaintiff to recover the full judgment from any one of several defendants, rather than collect from each one individually according to his degree of fault. The practical effect is that "deep pocket" defendants guarantee the recovery of huge judgments rendered by sympathetic juries, even in situations where they have been found only slightly at fault.

This application of the doctrine of joint and several liability is a radical departure from its originally intended application in cases where multiple defendants were in "concert

of action".[1] Unfortunately, modern courts have shown an increasing willingness to apply joint and several liability as a viable means of securing a financially sound sources from which to recover.

3. The explosive growth in noneconomic and punitive damages

Another identified problem area is the explosive growth in the damages awarded in tort lawsuits, particularly with regard to noneconomic awards, such as pain and suffering or punitive damages.

A recent report by Jury Verdict Research, Inc. indicated that the average medical malpractice jury verdict increased from $220,018 in 1975 to $1,017,716 in 1985 -- an increase of 363%.[2] The same report showed that the average product liability jury verdicts during this same period increased from $393,580 to $1,850,452, an increase of 370%.[3]

While it is difficult to quantify precisely how much of these awards are for noneconomic damages, it appears that noneconomic damages, such as awards for pain and suffering and punitive damages, are a substantial factor. For example, one

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[1]See generally Prosser and Keeton on Torts (5th Ed., 1984) Chapter 8.

[2]. Jury Verdict Research, Inc., Injury Valuation: Current Award Trends No. 304 (1986). The 1985 data is incomplete and is subject to refinement; however, the data is sufficient to show the trend in jury verdicts over the last decade.

[3]. Id.

study of medical malpractice jury awards found that in those cases where noneconomic damages above $100,000 were awarded, on the average the noneconomic component of the award amounted to 80% of the total award. The study also concluded that the noneconomic damages above $100,000 paid out in all such settlements and awards amounted to somewhere between one-quarter to one-half of all damages paid out for medical malpractice. [4]

Noneconomic damages are inherently unconstrained and subjective, and, therefore, are subject to dramatic inflation and wide variation. That is to say, in two cases involving similarly injured plaintiffs, because of the existence of these types of subjective damages, there is little chance that the two will receive comparable awards. The outcome and size of a particular award or settlement seemingly is based more on the defendant's perceived ability to pay rather than the extent of the injury to the plaintiff.

4. Excessive Transaction Costs

Finally, another serious problem of the tort system that should be noted is its extraordinarily high transaction costs.

It appears increasingly difficult to afford justice in this country. In fact, some would argue that the system, intended to benefit the injured and to do justice for all, primarily benefits the lawyers.

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[4]. H. Manne, Medical Malpractice Policy Guidebook, 132-48 (1985).

A study of liability cases from asbestos-related injuries by the Rand Corporation's Institute for Civil Justice indicated that out of every dollar paid out by the asbestos manufacturers and their insurers, an average of 62 cents is lost to attorneys' fees and litigation expenses.[5] Rand found that a typical asbestos court case results in a cost of $380,000. Of this, $125,000 is for legal defense fees, and $114,000 is for legal fees paid by the plaintiff. It is difficult to justify such exorbitant costs, particularly when these costs are usually borne by the seriously injured or the consumer through higher prices for goods and services.

The Reagan Administration's Legislative Package

On April 30, 1986, Attorney General Meese and Commerce Secretary Baldridge announced the Administration's support for three federal legislative proposals for civil justice reform. These proposals have been introduced in the House of Representatives as: H.R. 4766, The Product Liability Reform Act of 1986; H.R. 4765, The Government Contractor Liability Reform Act of 1986; and H.R. 4770, The Federal Tort Claims Reform Act of 1986. The specific provisions of these bills are based on the

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[5]J. Kakalik, P. Ebener, W. Felstiner, G. Haggstrom & M. Shanley, Variations in Asbestos Litigation Compensation and Expenses xviii (1984). These costs, of course, included both plaintiffs' and defendants' litigation expenses. In comparing the costs attributable to plaintiffs' litigation expenses it is useful to remember that defendants incur such costs whether or not they prevail, and, indeed may incur substantial costs defeating even clearly frivolous claims.

recommendations of the Tort Policy Working Group, contained in the February, 1986 Report. The Product Liability Reform Act of 1986 contains provisions that will:

- require liability to be based on fault,
- limit application of the doctrine of joint liability to those situations where the defendants have acted in concert,
- place a cap of $100,000 on the amount of non-economic damages -- such as pain and suffering, mental anguish and punitive damages -- that can be awarded,
- provide for future economic damages to be paid in periodic installments,
- modify collateral compensation doctrines to eliminate double recoveries by plaintiffs,
- alleviate the excessive transaction costs of our tort system by placing reasonable limits on contingency fees charged by attorneys, and
- encourage states to develop and use alternative dispute resolution mechanisms that will help alleviate burgeoning caseloads in the courts and allow injured parties to receive a greater share of any award in a more timely fashion.

The bill will assist those American businesses, particularly small businesses, that are unable to obtain reasonably affordable insurance because of the high costs of the current liability system. Of course, the ultimate effect of all this will be to

benefit consumers by lowering prices. And where injury is caused by the negligence of another, the injured party will receive a greater share of the damages and in a quicker fashion than if that party had to rely on the current legal system.

The second bill, The Government Contractor Liability Reform Act of 1986, will extend the product liability provisions outlined above to government contractors. It is drafted so as to cover government contractor services as well as products. Separate legislation to protect government contractors is necessary to ensure that the United States can obtain at a reasonable cost the goods and services necessary to further the public welfare.

The last bill is the Federal Tort Claims Reform Act of 1986, which contains provisions that, with few exceptions, are identical to the product liability reform legislation. Those provisions are made specifically applicable to the tort liability of the United States, thereby benefiting the American taxpayer whose federal tax dollars must satisfy every judgment against the government.

These legislative reforms are just a beginning, but they represent meaningful reforms appropriate for Federal legislation. The Administration believes this legislation will begin to correct the worst abuses of our present liability system, and will return our civil liability doctrines to fair and fault-based standards designed to compensate the injured party. They will

also provide a beneficial impact not only for the business community, but more importantly for consumers and taxpayers.

That concludes my testimony, I will be pleased to answer any questions you might have.